C O N F I D E N T I A L BUDAPEST 001000

SIPDIS

DEPARTMENT FOR EUR/CE; PLEASE PASS TO NSC FOR ADAM STERLING

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TAGS: PGOV ECON HU
SUBJECT: EAVESDROPPING; CONFIDENCE DROPPING: DOMESTIC
ESPIONAGE AND THE ECONOMY

REF: BUDAPEST 964 AND PREVIOUS

Classified By: P/E COUNSELOR ERIC V. GAUDIOSI; REASONS 1.4 (B) AND (D)

¶1. (SBU) Although largely eclipsed by the recent shocks to
the stock and bond markets (septel), Hungary's domestic
espionage scandal continues to expand in scope and could
further complicate economic triage efforts.

¶2. (C) Although criminal charges against the suspect firm,
UD Zrt, reportedly remain under investigation, FIDESZ Party
President Viktor Orban indicates to us privately that the
principal charges revolve around the importation of banned
technical equipment and the targeting of local law offices
engaged by Austrian oil giant) and Hungarian Oil Company
MOL rival - OMV.

¶3. (SBU) The case is increasingly being tried in the media
as the parties present widely divergent interpretations of
recent events.

THE SPIN CYCLE

¶4. (C) The government continues to portray the UD case as
the most serious scandal of the post-transition period. But
portraying is not proving. Despite the broad imputations of
politically-motivated espionage, even observers sympathetic
to the government admit there has been no smoking gun. As
center-left Progressziv Institut Director Kornelia Magyar
observes, "I would have hoped that the government would not
have made such serious allegations so lightly."

¶5. (C) To the opposition, the case represents the
government's return to classical Communist tactics of
distracting the public and intimidating potential rivals.
Conservative commentator Ivan Baba draws a parallel to
Moscow's treatment of Khodorovsky, charging that the
government has employed the security services to smear the
opposition and to warn influential UD clients such as OTP
bank chairman Sandor Csanyi to stay out of politics. Orban
maintains that the government has focused on Csanyi in the
mistaken belief that he is funding FIDESZ, citing the
government's actions as yet another example of the PM's focus
on "tomorrow's headlines" rather than the nation's
longer-term priorities.

¶6. (C) The object of the original allegations against UD,
MDF Party President Ibolya David, suffered a political
setback last week with the departure of another member of the
party's parliamentary faction. Combined with the recent
expulsion of David challenger Kornel Almassy (reftel), this
latest step brought the MDF's ranks in Parliament down to
nine MPs) one below the limit required for formal
consideration as a faction. After reportedly furious
negotiation, the MDF announced October 13 that former FIDESZ
MP Istvan Lengyel will join their faction, thus preserving
the party's rights on issues ranging from public funds to
committee assignments and speaking privileges.

ECONOMY SHAKEN; POLITICIANS STIRRED?

¶7. (C) Comment: The shock waves within the MDF are an
unintended consequence of the UD scandal, and there could
well be more to follow. The involvement of OTP in particular
could further undermine faith in Hungary's largest bank at a
time when the economy needs to maintain confidence at home
and abroad. The rapid descent of the domestic surveillance
scandal into a morass of conflicting accusations and
unintended consequences is the latest example of Hungary's
tendency to distract and divide rather than to decide. Most
observers agree that this week's counteraccusations from the
opposition have gone a long way to even the score. But the
disturbing tendency to reduce each issue to the lowest
political denominator raises the question as to whether the
body politic can rise above the partisan fray) especially
at a time when the country stands on the brink of serious
economic consequences. End Comment.
Foley